

Record of Discussion of the Exchange Fund Advisory Committee Sub-Committee on Currency Board Operations on 2 May 2003

(Approved for Issue by the Exchange Fund Advisory Committee on 29 May 2003)

Report on Currency Board Operations (27 March — 15 April 2003)

The Sub-Committee noted that this was a generally stable period. Nevertheless, concerns about the economic impact of the outbreak of atypical pneumonia had led to a firming of Hong Kong dollar interbank interest rates and a widening of spreads between Hong Kong dollar interest rates and their US counterparts. Members further noted that, slightly beyond the period covered by the report, the concerns about atypical pneumonia had contributed to a rise in Hong Kong dollar 12-month forward points, which, having peaked at around 370 in late April, had since eased to well below 300.

The Sub-Committee noted that, in accordance with Currency Board principles, changes in the Monetary Base during the reporting period had been fully matched by changes in the foreign reserves.

The report on Currency Board operations for the period under review is at [Annex](#).

Monitoring of Risks and Vulnerabilities

The Sub-Committee noted that the outlook of the global economy was clouded by the weaker-than-expected growth in the US in the first quarter and by continued weakness in Europe and Japan. In Asia, the near-term prospects had been further damaged by the outbreak of atypical pneumonia. Within Hong Kong, there were preliminary indications that the outbreak was having a significant impact on the economy, with sharp declines in tourist arrivals and resident departures, and the Purchasing Managers Index. Members noted that multinational institutions and private financial firms had downgraded their growth forecasts for the Asian economies: the downward revision for Hong Kong ranged from 0.5 to 3.0 percentage points.

Members observed that, for the time being, the outbreak of atypical pneumonia presented no immediate or direct concerns for currency stability. However, the profitability of the banking system could be affected, particularly if the outbreak persisted for a prolonged period.

The Macroeconomic Effects of Pressures on the Link: Some Estimates for 1990-2002

The Sub-Committee noted a report on research into the impact of speculative pressures (on the Link) on real economic

activity and prices in Hong Kong using data for the 1990-2002 period. The higher interest rates caused by the speculative attacks had resulted in a gradual fall in real GDP, with the peak effect being felt after about four quarters (reaching a level of 1.6% below benchmark) and a decline in prices over time (reaching about 1.5% below benchmark after three years).

Members observed that the findings of the research showed clearly that the economy as a whole was sensitive to, and responded to, speculative attacks on the currency. Members also observed that the technical measures introduced to improve the Currency Board system in 1998 (including the introduction of the discount window and a substantial increase in the size of the Monetary Base) had, through reducing the sensitivity of interest rates to speculative attacks, probably reduced the amount by which GDP and prices would decline following a speculative attack. They noted, however, that there was, for the time being, insufficient empirical data for this to be clearly shown.

An Analysis of Balance of Payments Developments in 2002

The Sub-Committee noted a report analysing balance of payment developments from a macroeconomic perspective, particularly in the light of Hong Kong's very strong current account surplus in 2002. The analysis indicated some autonomous net outflow of capital, financed in part by the current account surplus. However, the outflow was in line with economic fundamentals and there was no significant evidence of capital flight triggered by reduced confidence. The strong current account surplus reflected both an improvement in competitiveness, resulting from the depreciation of the real effective exchange rate, and weak domestic demand.

Members observed that it was likely that the current account surplus would be affected in the second quarter of 2003 by the sharp decline in tourist arrivals.

The Yen Exchange Rate and Net Foreign Assets

The Sub-Committee noted an information paper reporting on research into the trend (equilibrium) value of the yen by considering fundamental factors, such as net foreign assets. The findings supported the view that investment income generated by these assets underpinned the strength of the exchange rate in the long run, which helped to offset the negative impact on the exchange rate arising from weaknesses in the Japanese economy.

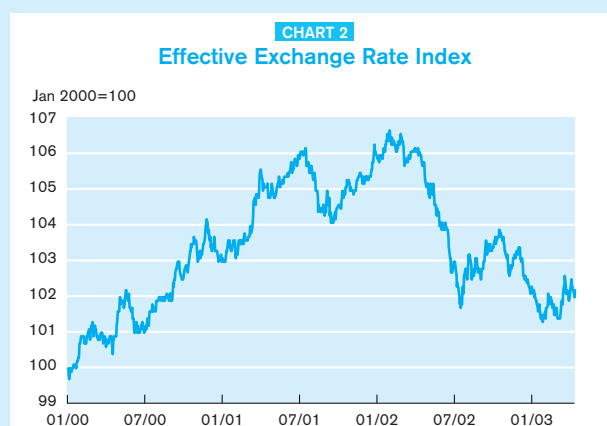
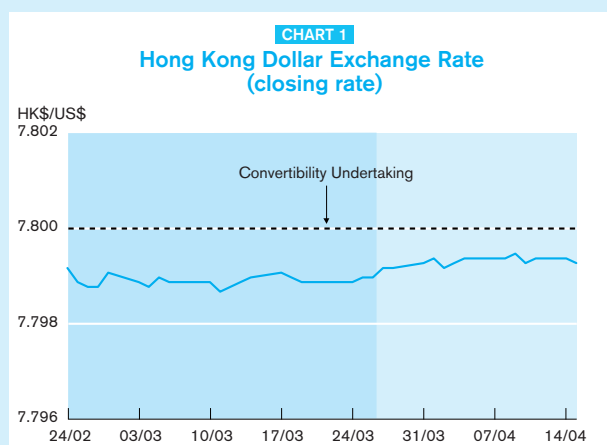
Annex

Report on Currency Board Operations (27 March – 15 April 2003)

The Hong Kong dollar and money markets remained stable during the reporting period. Partly reflecting concerns about the economic impact of atypical pneumonia, interbank interest rates firmed and the spreads against their US dollar counterparts widened. The Monetary Base increased marginally from HK\$250 billion to HK\$250.95 billion, attributable to an increase in the outstanding amount of Certificates of Indebtedness. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by changes in foreign reserves.

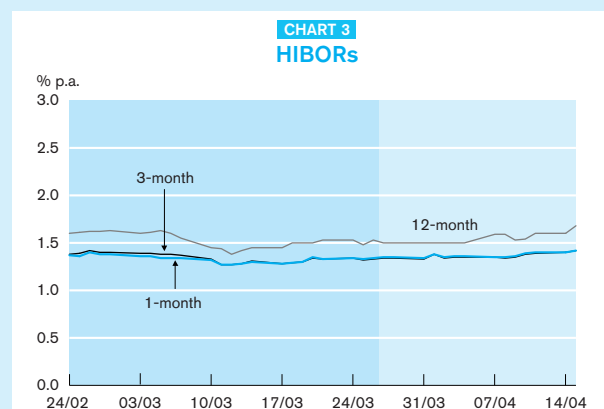
Hong Kong Dollar Exchange Rate

The Hong Kong dollar exchange rate remained stable and stayed within a narrow range of 7.7992 to 7.7995 throughout the reporting period. (Charts 1 and 2).

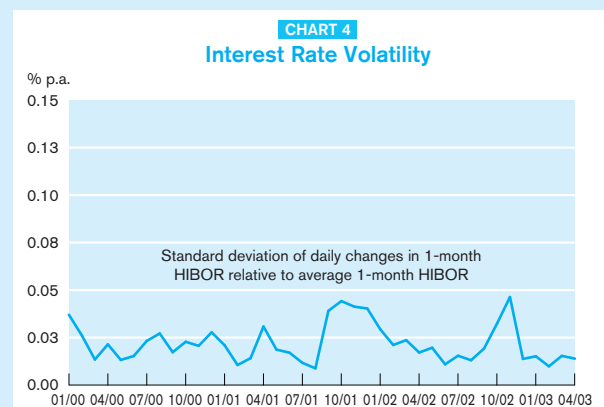


Interest Rates

Hong Kong dollar interest rates increased during the period. The 1-month and 3-month HIBORs rose by 7bp and 8bp respectively to close at 1.42%. The 12-month HIBOR followed a similar pattern, rising by 18bp to 1.68% (Chart 3).

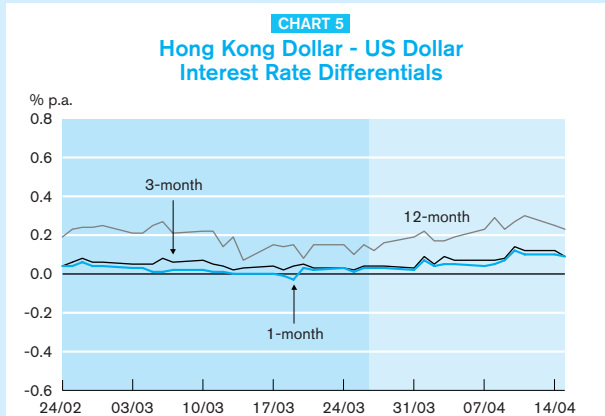


Interest rate volatility, as measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, remained low (Chart 4).¹

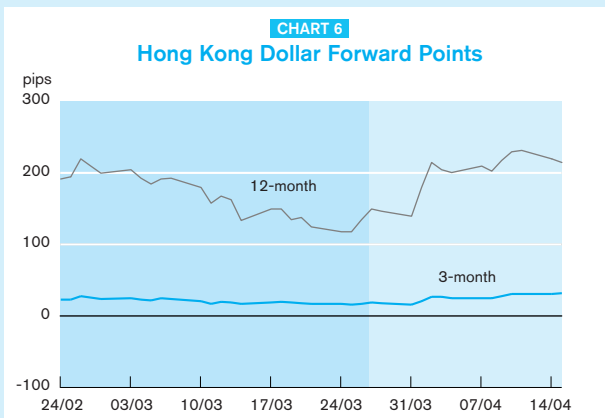


¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

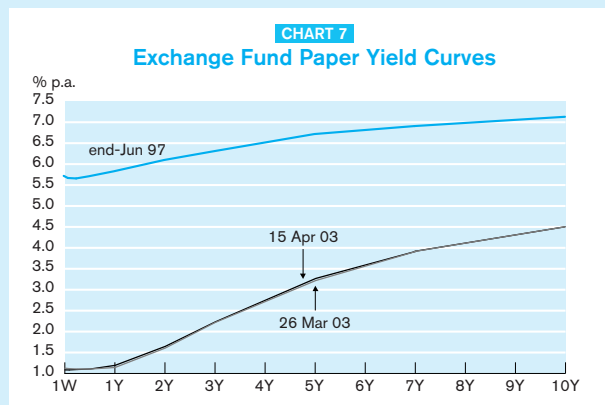
Spreads of Hong Kong dollar interbank interest rates over their US dollar counterparts widened during the period, reflecting concerns about the economic impact of the outbreak of atypical pneumonia. The 1-month and 3-month differentials both ended at 9bp, while the 12-month interest rate spread closed at 23bp (Chart 5).



Reflecting the movements in interest rate differentials, the Hong Kong dollar 3-month forward premium rose to close at 32 pips. Similarly, **the 12-month forward points increased from 150 pips to 215 pips** (Chart 6).



The yield curve of Exchange Fund paper was little changed during the period (Chart 7). The yield differential of 5-year paper over the US counterpart widened marginally to

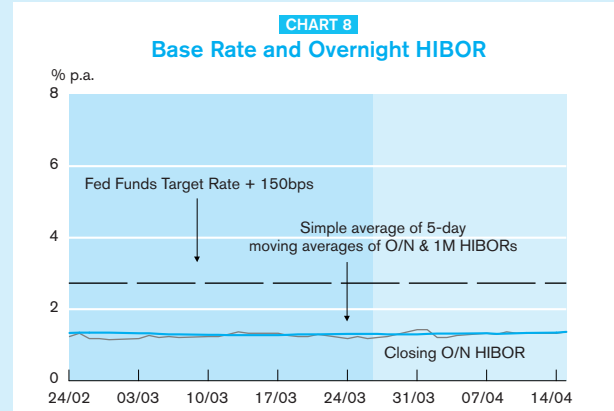


33 bp, while that of the 10-year paper decreased to 47bp (Table 1).

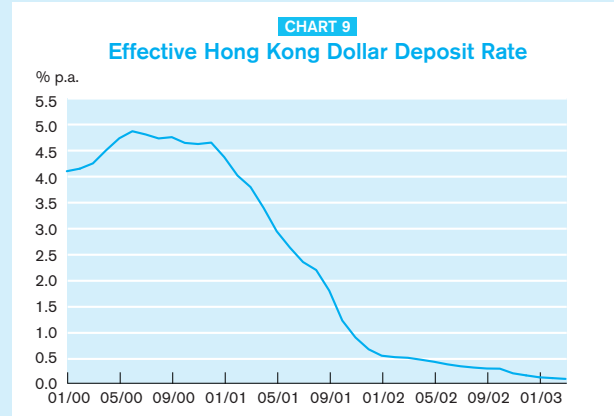
TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	26 Mar 03	15 Apr 03
3-month	56	-6	-6
1-year	21	-6	-7
3-year	3	15	14
5-year	27	32	33
10-year	54	54	47

The HKMA Base Rate stayed at 2.75% (Chart 8). The Best Lending Rate offered by major banks was also unchanged at 5%.



The average rate offered by major authorized institutions for 1-month time deposits was unchanged at 0.09% during the period.² Meanwhile, the effective deposit rate declined slightly in March 2003 (Chart 9).³



² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

³ This is the average of the interest rates on demand, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

Monetary Base

The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased slightly from HK\$250 billion to HK\$250.95 billion during the reporting period** (Table 2). Movements in individual components are discussed below.

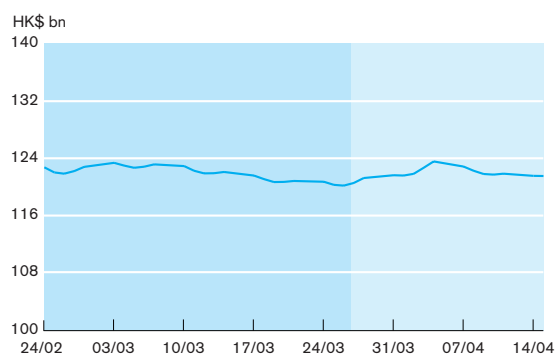
TABLE 2
Monetary Base

(HK\$ bn)	27 Mar 03	15 Apr 03
CIs	120.85	121.83
Government-issued Currency Notes and Coins in Circulation	6.58	6.52
Aggregate Balance	0.54	0.53
Outstanding EFBNs	122.04	122.08
Monetary Base	250.00	250.95

Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.13 billion in exchange for HK\$0.98 billion worth of CIs. As a result, the **outstanding amount of CIs increased from HK\$120.85 billion to HK\$121.83 billion** (Chart 10).

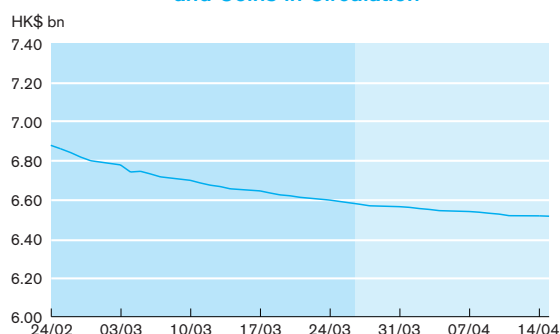
CHART 10
Certificates of Indebtedness



Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation decreased** from HK\$6.58 billion to HK\$6.52 billion during the period (Chart 11).

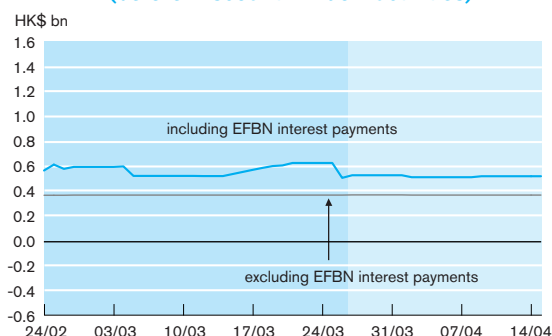
CHART 11
Government-issued Currency Notes and Coins in Circulation



Aggregate Balance

The **Aggregate Balance remained stable** at around HK\$0.53 billion during the period, with small fluctuations reflecting interest payments on Exchange Fund paper (Chart 12).

CHART 12
Aggregate Balance (before Discount Window activities)



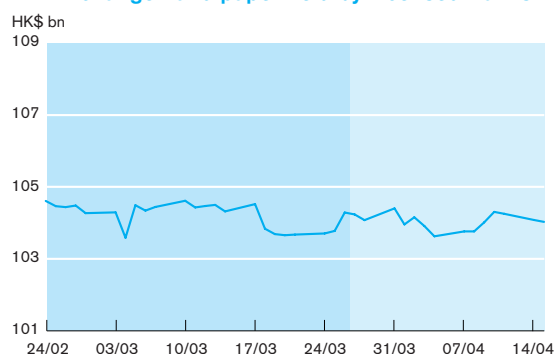
Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper increased slightly from HK\$122.04 billion to HK\$122.08 billion. The increase was mainly a result of additional net issues. All issues of Exchange Fund Bills and Notes were well received by the market (Table 3). Holdings of Exchange Fund paper by the banking sector (before Discount Window activity) decreased marginally from HK\$104.27 billion (85.44% of total) to HK\$104.06 billion (85.24% of total) during the period (Chart 13).

TABLE 3
Issuance of Exchange Fund Bills and Notes
(27 March – 15 April 03)

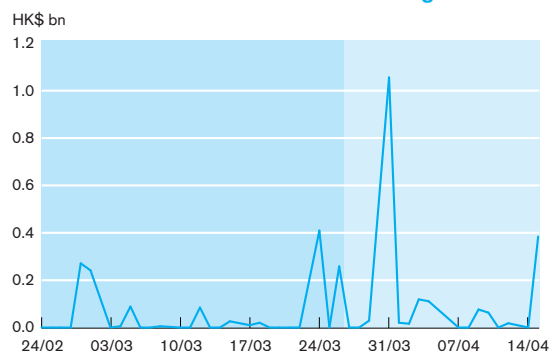
	No. of issues launched	Over-subscription ratio
3-month EFB	2	6.10 - 6.66
6-month EFB	1	7.96
1-year EFB	1	6.50

CHART 13
Exchange Fund paper held by Licensed Banks



During the period, interest payments of HK\$0.05 billion were made on Exchange Fund paper. An additional HK\$0.04 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments. The remaining amount was carried forward in the Aggregate Balance.

CHART 14
Discount Window Borrowing



Discount Window Activity

For the period as a whole, 7 banks borrowed a total of HK\$1.88 billion from the Discount Window, compared with HK\$1.42 billion in the preceding period (Chart 14). All of them used Exchange Fund paper as collateral (Table 4).

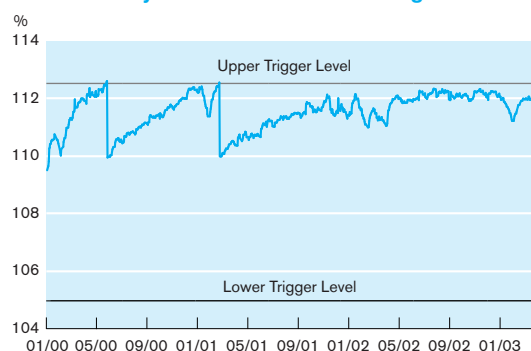
TABLE 4
Frequency of Individual Bank
Access to the Discount Window
(27 March – 15 April 03)

Frequency of using Discount Window	No. of banks
1	4
2	1
3	2
Total	7

Backing Portfolio

Backing assets increased slightly during the period, largely as a result of an increase in the outstanding amount of CIs. Nevertheless, as the Monetary Base rose proportionately more than the backing assets, the backing ratio decreased slightly from 111.91% on 27 March to 111.86% on 15 April 2003 (Chart 15). Under the Linked Exchange Rate system, while specific Exchange Fund assets have been designated for the backing portfolio, all Exchange Fund assets are available to support the Hong Kong dollar exchange rate.

CHART 15
Daily Movement of the Backing Ratio

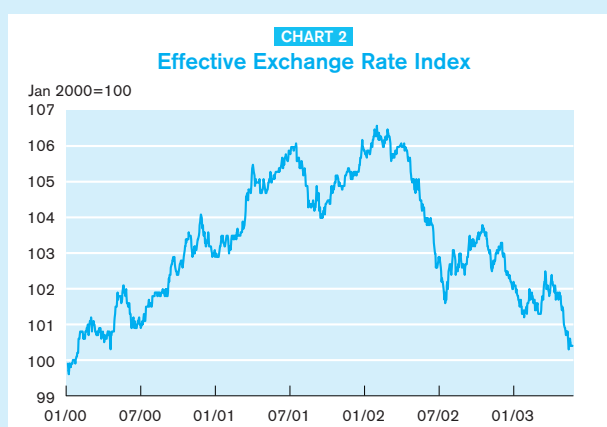
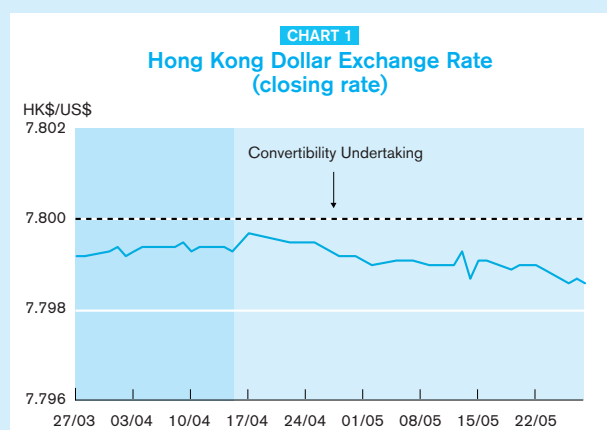


Report on Currency Board Operations (16 April - 28 May 2003)

The Hong Kong dollar strengthened slightly during the reporting period on a decreasing number of cases of severe acute respiratory syndrome (SARS). Interbank interest rates eased, and the spreads against their US dollar counterparts narrowed. The Monetary Base declined marginally from HK\$252.10 billion to HK\$250.99 billion, attributable to a fall in the outstanding amount of Certificates of Indebtedness. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

Hong Kong Dollar Exchange Rate

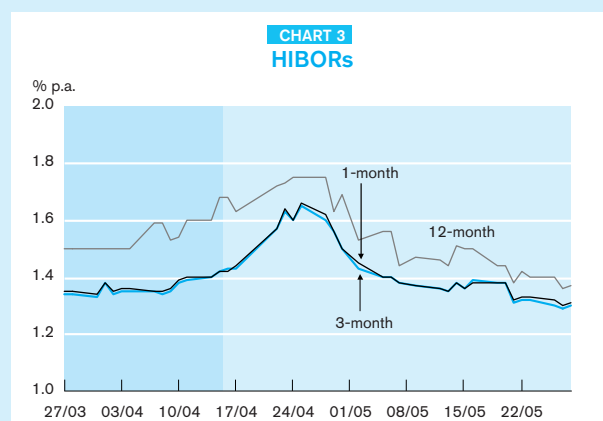
The Hong Kong dollar exchange rate strengthened slightly from 7.7995 to 7.7986 during the reporting period. The number of SARS cases declined, and the travel warning on Hong Kong by the World Health Organisation (WHO) was lifted, easing market concerns about the economic impact of the disease (Charts 1 and 2).



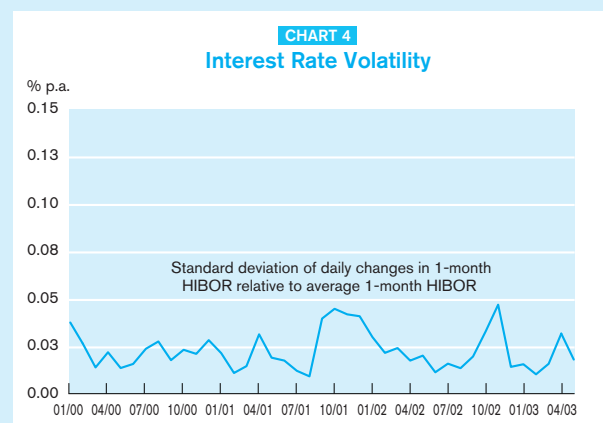
¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

Interest Rates

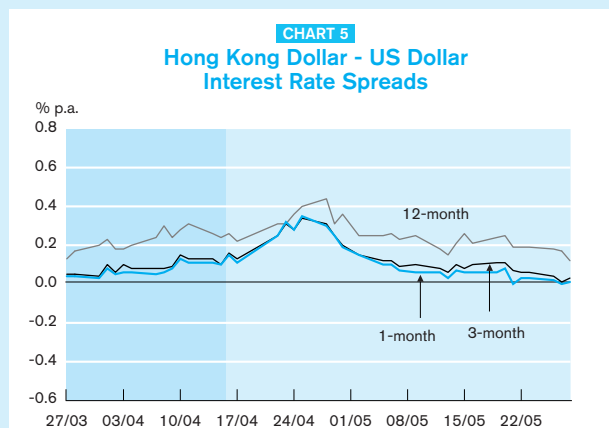
Hong Kong dollar interest rates decreased during the period. The 1-month and 3-month HIBORs dropped by 11 bp and 13 bp to 1.31% and 1.30% respectively. The 12-month HIBOR followed a similar pattern, declining by 31 bp to 1.37% (Chart 3).



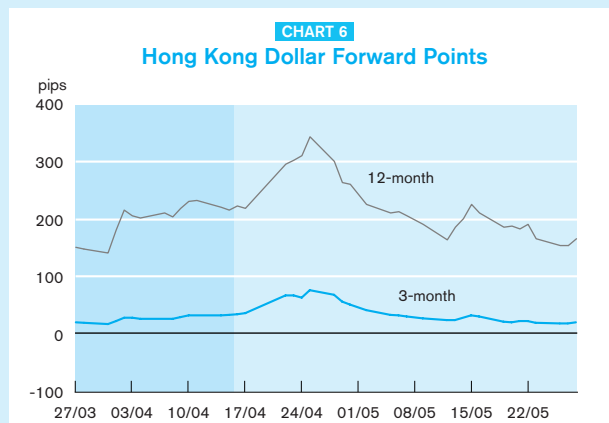
Interest rate volatility, as measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, remained low (Chart 4).¹



Spreads of Hong Kong dollar interbank interest rates over their US dollar counterparts rose in the early part of the period, reflecting worries about the impact of SARS on the local economy and the fiscal deficit. As the situation was brought under control, the 1-month and 3-month spreads dropped to close at zero and 2 bp respectively, while the 12-month interest rate differential decreased to around 11 bp (Chart 5).



In line with the movements in interest rate spreads, the Hong Kong dollar 3-month forward premium rose to a peak of 75 pips before subsiding to 19 pips at the end of the period. Similarly, **the 12-month forward points increased to a peak of 343 pips before easing to close at 165 pips** (Chart 6).



Except for the short term, **the yield curve of Exchange Fund paper shifted downward during the period** (Chart 7), reflecting both declines in US Treasury yields and a reduced yield spread at the longer end. The yield differential of 5-year paper over the US counterpart shrank notably to 20 bp, while that of the 10-year paper dropped by 7 bp to 40bp (Table 1).

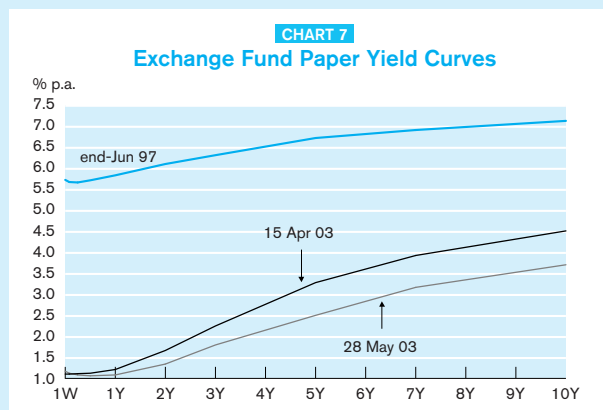
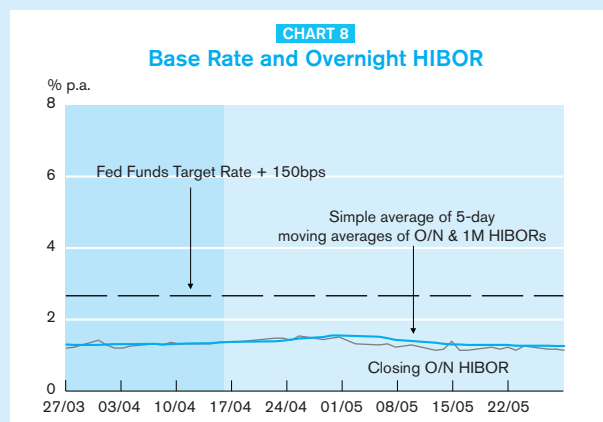


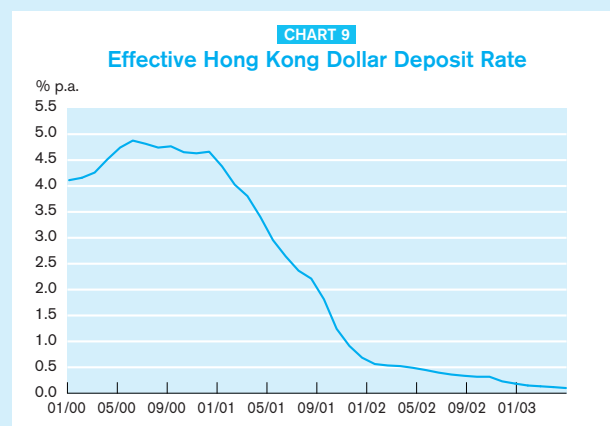
TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	15 Apr 03	28 May 03
3-month	56	-6	0
1-year	21	-7	-2
3-year	3	14	19
5-year	27	33	20
10-year	54	47	40

The HKMA Base Rate stayed at 2.75% (Chart 8). The Best Lending Rate offered by major banks was also unchanged at 5%.



The average rate offered by major authorized institutions for 1-month time deposits edged down to **0.08%** during the period.² Meanwhile, the effective deposit rate declined slightly in April 2003 (Chart 9).³



Monetary Base

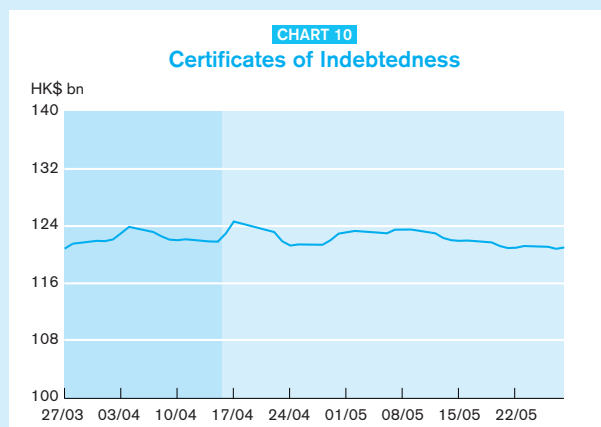
The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **decreased slightly from HK\$252.10 billion to HK\$250.99 billion during the reporting period** (Table 2). Movements in individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	16 Apr 03	28 May 03
CIs	122.96	121.00
Government-issued Currency Notes and Coins in Circulation	6.51	6.40
Aggregate Balance	0.54	0.58
Outstanding EFBNs	122.09	123.02
Monetary Base	252.10	250.99

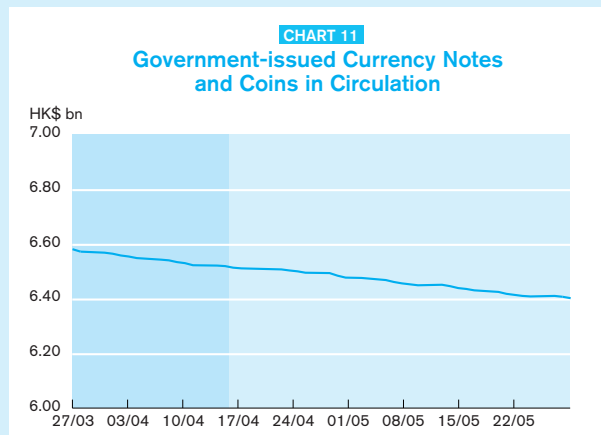
Certificates of Indebtedness

During the period, the three note-issuing banks redeemed from the HKMA a total of HK\$1.96 billion worth of CIs in exchange for US\$0.25 billion. As a result, the **outstanding amount of CIs decreased from HK\$122.96 billion to HK\$121.00 billion** (Chart 10).



Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation decreased** from HK\$6.51 billion to HK\$6.40 billion during the period (Chart 11).

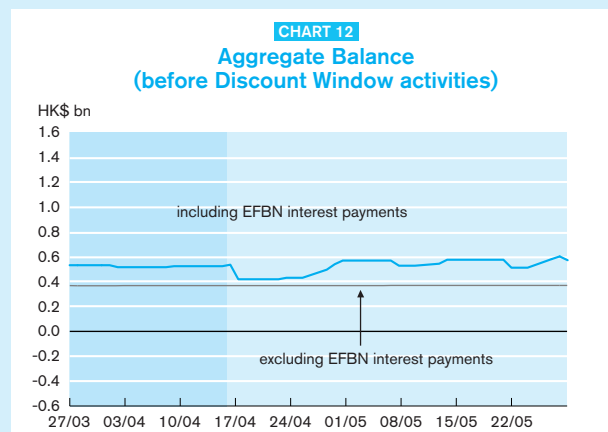


² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

³ This is the average of the interest rates on demand, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

Aggregate Balance

The **Aggregate Balance** remained stable at around HK\$0.53 billion during the period, with small fluctuations reflecting interest payments on Exchange Fund paper (Chart 12).



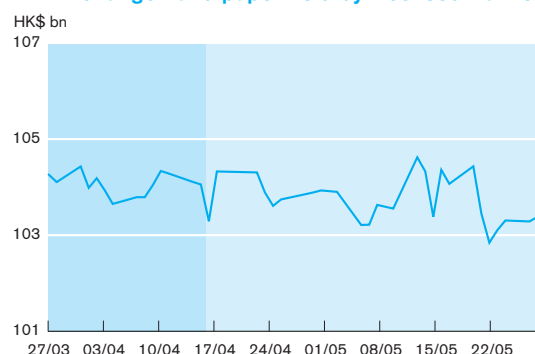
Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper rose slightly from **HK\$122.09 billion** to **HK\$123.02 billion**. The increase was mainly a result of additional net issues. All issues of Exchange Fund Bills and Notes were well received by the market (Table 3). **Holdings of Exchange Fund paper by the banking sector (before Discount Window activity) decreased marginally** from HK\$103.30 billion (84.60% of total) to HK\$103.22 billion (83.91% of total) during the period (Chart 13).

TABLE 3
Issuance of Exchange Fund Bills and Notes
(16 April – 28 May 03)

	No. of issues launched	Over-subscription ratio
3-month EFB	6	3.10 - 5.34
6-month EFB	3	8.23 - 9.45
1-year EFB	1	6.07
2-year EFN	1	5.44
3-year EFN	1	3.18
7-year EFN	1	5.75

CHART 13
Exchange Fund paper held by Licensed Banks



During the period, **interest payments of HK\$0.37 billion were made on Exchange Fund paper. An additional HK\$0.32 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance.

Discount Window Activity

For the period as a whole, **15 banks borrowed a total of HK\$2.93 billion from the Discount Window**, compared with HK\$1.88 billion in the preceding period (Chart 14). All of them used Exchange Fund paper as collateral (Table 4).

CHART 14
Discount Window Borrowing

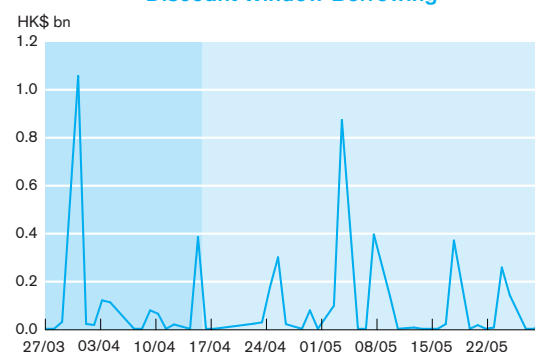
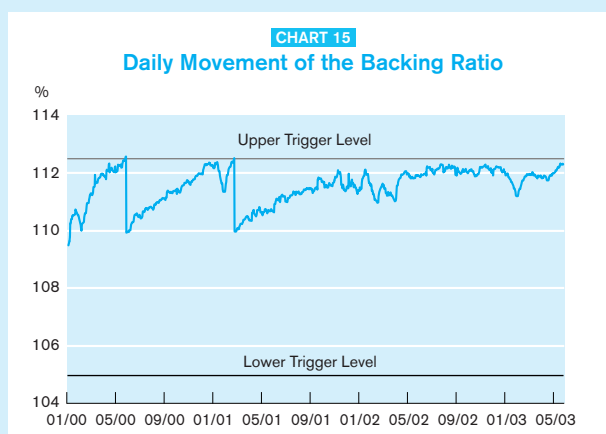


TABLE 4
Frequency of Individual Bank Access to the Discount Window
(16 April – 28 May 03)

Frequency of using Discount Window	No. of banks
1	11
2	1
3	1
4	1
6	1
Total	15

Backing Portfolio

Backing assets fell slightly during the period, largely as a result of a decline in the outstanding amount of CIs. Nevertheless, as the Monetary Base decreased proportionately more than the backing assets, **the backing ratio increased slightly from 111.82% on 16 April to 112.31% on 28 May 2003** (Chart 15). Under the Linked Exchange Rate system, while specific Exchange Fund assets have been designated for the backing portfolio, all Exchange Fund assets are available to support the Hong Kong dollar exchange rate.



Record of Discussion of the Exchange Fund Advisory Committee Sub-Committee on Currency Board Operations on 4 July 2003

(Approved for Issue by the Exchange Fund Advisory Committee on 31 July 2003)

Report on Currency Board Operations (29 May — 20 June 2003)

The Sub-Committee noted that the Hong Kong dollar and exchange markets had continued to be stable in June. Having risen to a near-term high of 182 pips on 17 June, following conjecture about a widening of the official trading band of the renminbi, Hong Kong dollar 12-month forward points had declined in late June. Interest spreads between the Hong Kong dollar and US dollar continued to decline with the winding down of the SARS episode.

Members noted the publication on 27 June of the letter from the Financial Secretary to the Monetary Authority, dated 25 June 2003, formally specifying the monetary policy objective and the structure of the monetary system of Hong Kong: this was defined in the letter as continuing to be a stable external exchange value of the currency of Hong Kong, in terms of its exchange rate in the foreign exchange market against the US dollar, at around HK\$7.80 to US\$1, maintained through a currency board system. These arrangements reflected the Linked Exchange Rate system in existence in Hong Kong since October 1983.

The Sub-Committee noted that, in accordance with Currency Board principles, changes in the Monetary Base during the reporting period had been fully matched by changes in the foreign reserves.

The report on Currency Board operations for the period under review is at [Annex](#).

Monitoring of Risks and Vulnerabilities

The Sub-Committee noted that, despite some signs of improvement in the latest data from the US, growth in the major economies continued to be sluggish. Equity markets had nevertheless continued to rally in expectation of better economic growth. In Hong Kong, financial conditions had improved with the end of the SARS episode, and merchandise exports had continued to perform strongly. However, domestic demand was generally expected to recover only gradually, given the high rate of unemployment.

The Sub-Committee noted a special analysis of the decline in the ratio of Hong Kong dollar deposits to total deposits. The analysis found that the decline was attributable to macroeconomic and financial market developments rather than

to pressures on the currency. Specifically, the factors likely to have contributed to the decline were weaker economic growth relative to Hong Kong's main trading partners and a robust external trade performance, which had increased the demand for foreign currency. Members noted that the relatively low level of the ratio of domestic currency deposits to total deposits in Hong Kong was similar to that in other major international financial centres. Members observed that there appeared to be no consistent relationship between confidence in the Hong Kong dollar and the ratio of Hong Kong dollar deposits to total deposits.

The Profitability of the Banking Sector in Hong Kong

The Sub-Committee considered an information paper examining the various factors affecting the profitability of the banking sector in Hong Kong against a background of economic difficulty and a changing operating environment. The Sub-Committee noted that a profitable banking sector would be better able to withstand negative shocks and contribute to the stability of the financial system. The paper found that both macroeconomic and bank-specific factors were important determinants of bank profitability. Among macroeconomic variables, GDP growth, inflation and real interest rates were positively linked to profitability. Bank-specific variables indicated that operational efficiency was the most important factor in determining profitability. Members observed that deterioration in profitability in recent years was mainly attributable to macroeconomic factors, especially deflation, and that bank profitability should in general improve as the economy recovered.

The Causes of Inflation and Deflation on the Mainland

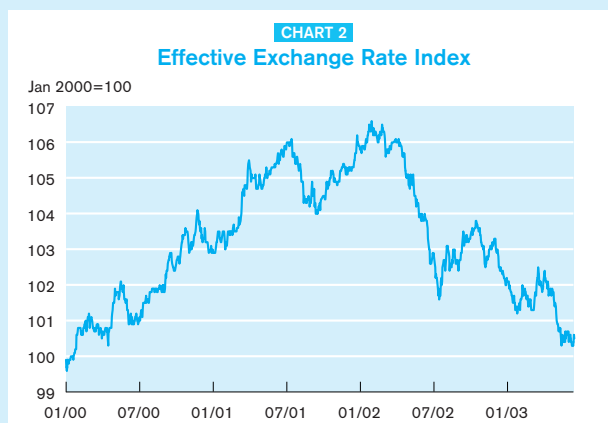
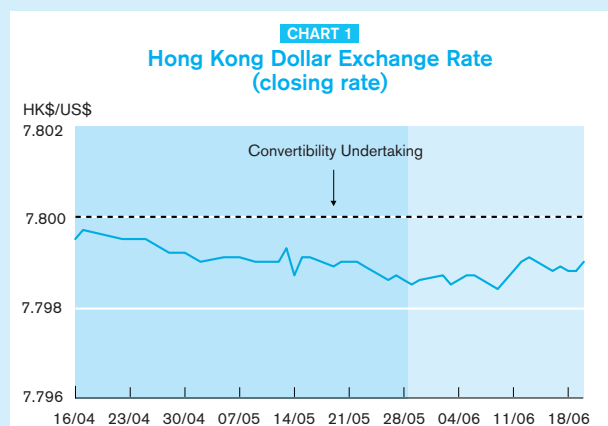
The Sub-Committee noted a study of inflation dynamics on the Mainland since the late 1980s. The study found that main factors behind deflation were the appreciation of the effective exchange rate of the renminbi and growth in productivity.

Annex Report on Currency Board Operations (29 May – 20 June 2003)

The Hong Kong dollar weakened slightly during the reporting period, on speculations about a widening of the official trading band of the renminbi. Hong Kong dollar interest rates eased on expectations of a rate cut in the US and relative to US dollar rates following diminishing concerns about severe acute respiratory syndrome (SARS). The Monetary Base rose modestly from HK\$251.52 billion to HK\$252.25 billion, attributable to a rise in the outstanding amount of Certificates of Indebtedness and Exchange Fund paper. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

Hong Kong Dollar Exchange Rate

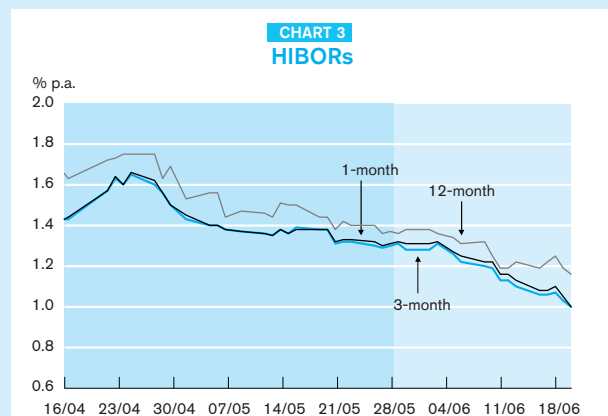
The Hong Kong dollar exchange rate weakened slightly from 7.7985 to 7.7990 during the reporting period, reflecting market speculations about a widening of the official trading band of the renminbi. The effective exchange rate index declined moderately as well (Charts 1 and 2).



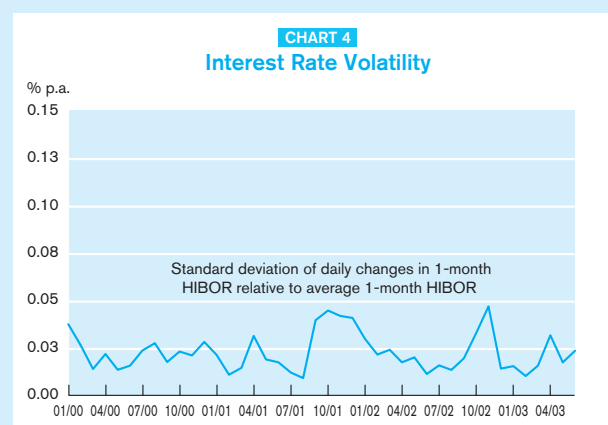
¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

Interest Rates

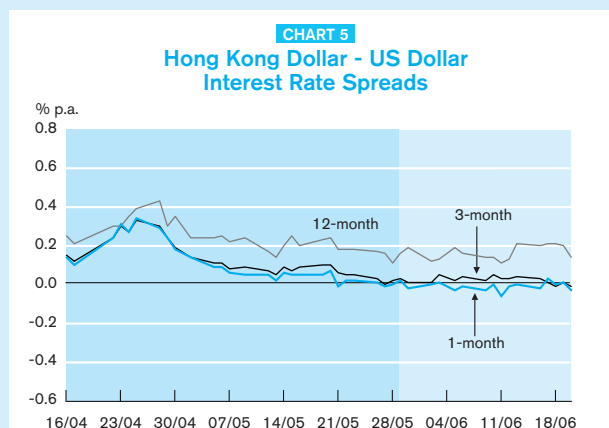
Except for the overnight rate, Hong Kong dollar interest rates generally eased on expectations of a rate cut in the US and further narrowing of their spreads over US dollar counterparts. Both 1-month and 3-month HIBORs dropped by about 30 bp to 1.0% during the reporting period. Similarly, the 12-month HIBOR decreased by 20 bp to 1.16% (Chart 3).



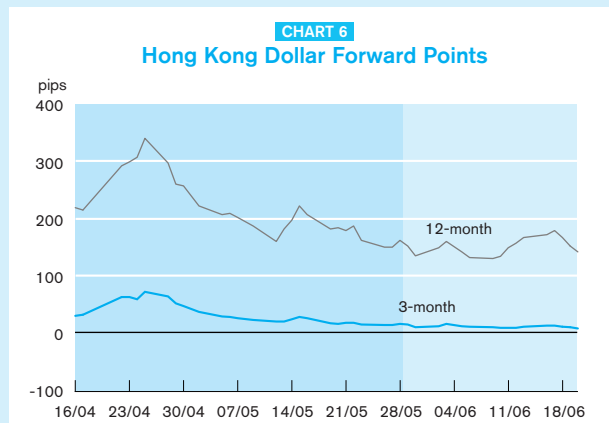
Interest rate volatility, as measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, remained low (Chart 4).¹



Spreads of Hong Kong dollar interbank interest rates over their US dollar counterparts continued to decline during the period, reflecting diminishing concerns about the impact of SARS. The 1-month and 3-month spreads dropped by about 5 bp to -3 bp and -1 bp respectively, while the 12-month spread decreased to 14 bp (Chart 5).



Mirroring the movements in interest rate spreads, the Hong Kong dollar 3-month forward premium softened during the period. **The 12-month forward points rose to a near-term high of 182 pips on 17 June**, on speculations about a widening of the official trading band for the renminbi following US Treasury Secretary Snow's verbal support for a more flexible exchange rate regime in China, **before easing to close at 145 bp** (Chart 6).



Yields on Exchange Fund paper declined in the short and intermediate ends, reflecting market expectations of a rate cut in the US (Chart 7). The yield differential of 5-year paper over the US counterpart increased to 27 bp, while that of the 10-year paper went up marginally to 41 bp (Table 1).

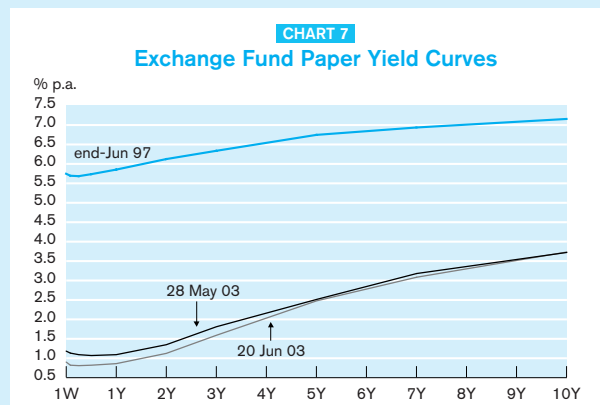
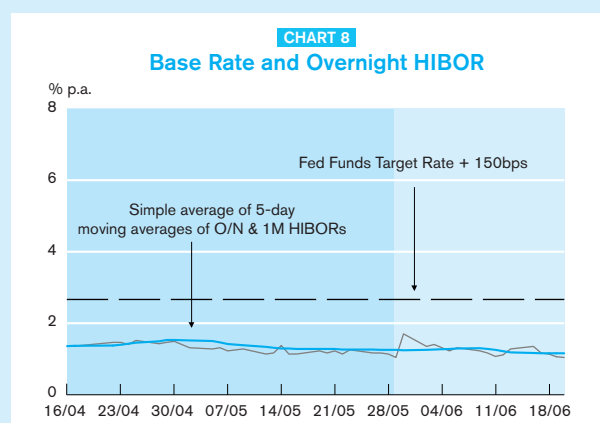


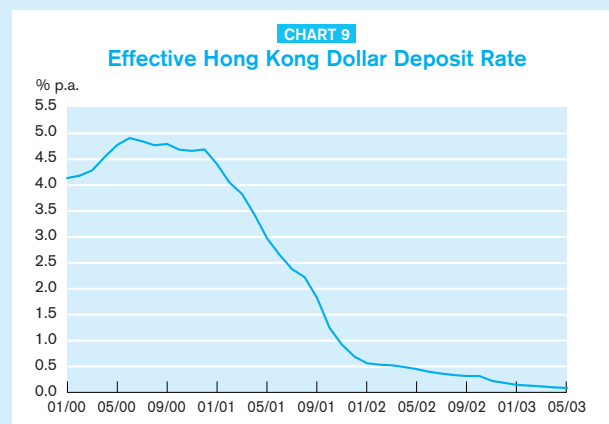
TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	28 May 03	20 June 03
3-month	56	0	5
1-year	21	-2	3
3-year	3	19	16
5-year	27	20	27
10-year	54	40	41

The HKMA Base Rate stayed at 2.75% (Chart 8). The Best Lending Rate offered by major banks was also unchanged at 5%.



The average rate offered by major authorized institutions for 1-month time deposits remained unchanged at 0.08% during the period.² Meanwhile, the effective deposit rate declined slightly in May 2003 (Chart 9).³



Monetary Base

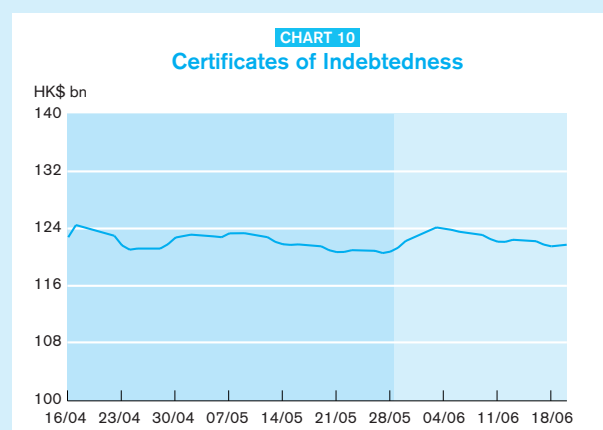
The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased marginally from HK\$251.52 billion to HK\$252.25 billion during the reporting period** (Table 2). Movements in individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	29 May 03	20 June 03
CIs	121.52	121.94
Government-issued Currency Notes and Coins in Circulation	6.40	6.35
Aggregate Balance	0.58	0.66
Outstanding EFBNs	123.03	123.31
Monetary Base	251.52	252.25

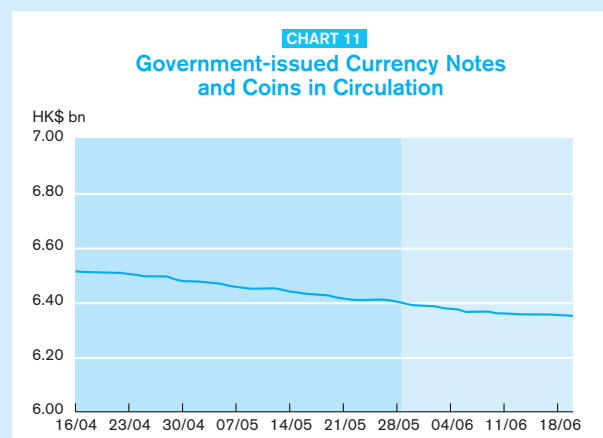
Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.054 billion in exchange for HK\$0.42 billion worth of CIs. As a result, the **outstanding amount of CIs increased modestly from HK\$121.52 billion to HK\$121.94 billion** (Chart 10).



Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation decreased** from HK\$6.40 billion to HK\$6.35 billion during the period (Chart 11).

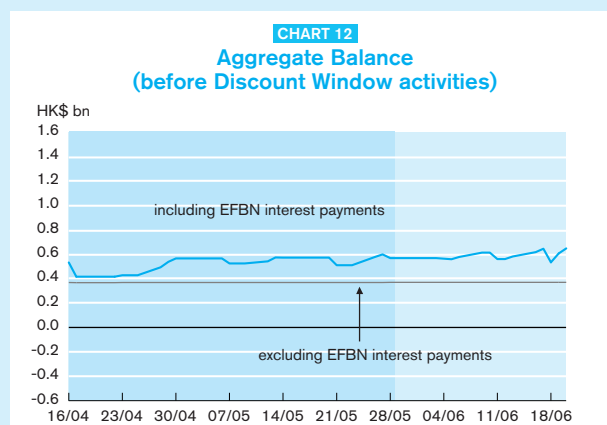


² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

³ This is the average of the interest rates on demand, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

Aggregate Balance

The **Aggregate Balance** remained stable at around HK\$0.59 billion during the period, with small fluctuations reflecting interest payments on Exchange Fund paper (Chart 12).



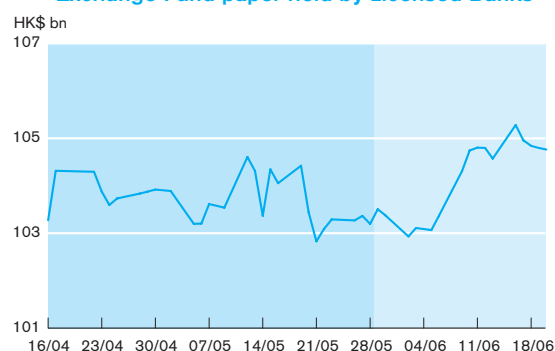
Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper rose slightly from HK\$123.03 billion to HK\$123.31 billion. The increase was mainly a result of additional net issues. All issues of Exchange Fund Bills and Notes were well received by the market (Table 3). **Holdings of Exchange Fund paper by the banking sector (before Discount Window activity) increased** from HK\$103.53 billion (84.15% of total) to HK\$104.79 billion (84.97% of total) during the period (Chart 13).

TABLE 3
Issuance of Exchange Fund Bills and Notes
(29 May – 20 June 03)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	10.4
3-month EFB	3	5.87 - 6.97
6-month EFB	1	8.55
1-year EFB	1	7.17
5-year EFN	1	4.58
10-year EFN	1	5.76

CHART 13
Exchange Fund paper held by Licensed Banks



During the period, **interest payments of HK\$0.36 billion were made on Exchange Fund paper. An additional HK\$0.30 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance.

Discount Window Activity

For the period as a whole, **9 banks borrowed a total of HK\$1.83 billion from the Discount Window**, compared with HK\$2.93 billion in the preceding period (Chart 14). All of them used Exchange Fund paper as collateral. Banks used the Discount Window infrequently (Table 4).

CHART 14
Discount Window Borrowing

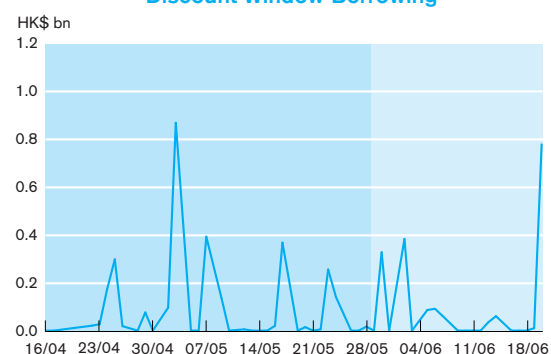


TABLE 4
Frequency of Individual Bank Access to the Discount Window
(29 May – 20 June 03)

Frequency of using Discount Window	No. of banks
1	7
2	1
3	1
Total	9

Backing Portfolio

Backing assets increased slightly during the period, largely as a result of an increase in the outstanding amount of CIs and valuation changes. Nevertheless, as the Monetary Base increased proportionately more than the backing assets, **the backing ratio decreased slightly from 112.27% on 29 May to 112.12% on 20 June** (Chart 15). Under the Linked Exchange Rate system, while specific Exchange Fund assets have been designated for the backing portfolio, all Exchange Fund assets are available to support the Hong Kong dollar exchange rate.

